Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms	)	CC Docket No. 98-171
	)	
Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990	)	CC Docket No. 90-571
	)	
Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size	)	CC Docket No. 92-237 NSD File No. L-00-72
	)	
Number Resource Optimization	)	CC Docket No. 99-200
	)	
Telephone Number Portability	)	CC Docket No. 95-116
	)	
Truth-in-Billing and Billing Format	)	CC Docket No. 98-170

COMMENTS OF CONSUMERS UNION, TEXAS OFFICE OF PUBLIC UTILITY COUNSEL, CONSUMER FEDERATION OF AMERICA, APPALACHIAN PEOPLE'S ACTION COALITION, CENTER FOR DIGITAL DEMOCRACY, EDGEMONT NEIGHBORHOOD COALITION AND MIGRANT LEGAL ACTION PROGRAM

Of Counsel:

Michael Garcia
Law Student
Georgetown University Law Center

James A. Bachtell, Esq.
Angela J. Campbell, Esq.
Institute for Public Representation
Georgetown University Law Center
600 New Jersey Avenue, NW
Washington, DC 20001
(202) 662-9535

Counsel for CU *et al.*

Mark Cooper
Director of Research
CONSUMER FEDERATION OF AMERICA
1424 16th Streeet NW
Suite 604
Washington, DC 20036
(202) 387-6121

Laurie Pappas
Deputy Public Counsel
Texas State Bar No. 12128690
Texas Office of Public Utility Counsel
1701 North Congress Ave.
Suite 9-180
P.O. Box 12397
Austin, TX 78711-2397
(512) 936-7500

February 28, 2003

SUMMARY

Consumers Union, Texas Office of Public Utility Counsel, Consumer Federation of America, Appalachian People's Action Coalition, Center for Digital Democracy, Edgemont Neighborhood Coalition, and Migrant Legal Action Program ("CU *et al.*"), by their attorneys, the Institute for Public Representation ("IPR"), support the interim measures established by the Commission in its *Report and Order and Second Further Notice of Proposed Rulemaking* of December 12, 2002 ("*Second Further Notice*"),[1] and oppose the proposals to alter the universal service funding mechanism. These proposals would increase phone rates for many low-income and elderly customers and discriminate against certain classes of carriers.

CU *et al.* believe that the interim measures taken by the Commission will likely be sufficient to ensure the long-term stability of the Universal Service Fund ("USF"). Increasing the safe harbor on wireless interstate telecommunication providers will significantly increase the amount of revenue available for the USF, and will better ensure that all interstate communications carriers are assessed in an equitable and competitively neutral manner. The interim measure prohibiting carriers from recovering USF costs through a separate line item that includes a mark-up above the current contribution factor will also serve to increase administrative efficiency by carriers and reduce phone rates for consumers. The Commission should therefore not consider overhauling the USF assessment system until the interim measures are given an opportunity to succeed.

Based upon the information made available by the Commission, all three proposals presented for comment fail to comply with Section 254 of the Communications Act, which instructs the Commission to create a USF assessment methodology that ensures that quality

[1] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order and Second Further Notice of Proposed Rulemaking (rel. Dec. 13, 2002) ("*Second Further Notice*").

telecommunication service is available to consumers at just, reasonable, and affordable rates. The connections-based plans enable telecommunications carriers to inequitably increase USF-related fees for low-volume consumers to the same level as those fees charged to high-volume consumers, despite the significant disparity in long-distance usage patterns between these classes of consumers. This increase in fee assessments would be particularly detrimental to low-income and elderly individuals, that are disproportionately low-volume consumers. The administrative costs incurred by carriers under each proposal will further exacerbate this increase in phone rates. Although more data is necessary to assess the full impact the proposals would have, it appears clear that all but the highest-volume consumers would be made worse off under any of the three proposals than under the interim measures.

Moreover, each of the three proposals presented for comment by the Commission fails to assess carriers in an equitable and nondiscriminatory manner, imposing inequitable USF contribution obligations upon low-volume carriers and, in the case of Proposal # 3, exempting a significant class of telecommunications carriers from any meaningful contribution obligation whatsoever.

In light of the inequities incurred as a result of implementing any of the proposals presented by the Commission, CU *et al.* strongly urge the Commission to maintain its interim regulations so it can be determined whether raising the wireless safe harbor will sufficiently resolve USF sustainability concerns, and whether the shift to projected revenues solves competitiveness and equity problems between service providers.

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CU *ET AL.*

Consumers Union, Texas Office of Public Utility Counsel, Consumer Federation of America, Appalachian People's Action Coalition, Center for Digital Democracy, Edgemont Neighborhood Coalition, and Migrant Legal Action Program ("CU *et al.*"), by their attorneys, the Institute for Public Representation ("IPR"), hereby submit the following comments in response to the Commission's *Second Further Notice*.

In an effort to ensure the long-term stability and sufficiency of the USF, the Commission issued interim regulations on December 12, 2002 modifying the USF contribution methodology. The interim regulations increase from 15% to 28.5% the safe harbor that wireless carriers may use to estimate their interstate communication revenue, thereby ensuring that those wireless carriers that rely on the safe harbor to estimate their USF obligations will contribute a greater and more proportionate amount of revenue into the USF.[2] The Commission also prohibited carriers, beginning April 1, 2003, from recovering USF costs through a separate line item that includes a mark-up above the current contribution factor.[3] Finally, the Commission acted to prevent USF contributions from becoming a barrier to competition by requiring USF contributions to be based upon projected, collected interstate revenues rather than historical, gross-billed revenues. This measure helps to ensure that new carriers with increasing revenues will not have a competitive edge over established carriers.[4]

Although the Commission believes that these interim regulations will improve the sustainability of the USF, it seeks comment regarding the viability of three proposals to replace the present USF assessment system. The proposals include a plan that would assess carriers a flat-fee for every connection provided, and assess carriers not providing connections to end-users according to a set revenue percentage ("Proposal #1"); [5] a plan that would assess all end-user connections on the basis of connection capacity, and assess carriers not directly providing connections to end users on a revenue-basis ("Proposal #2");[6] and a plan that would assesses

[2] *Id.* at ¶ 21.
[3] *Id.* at ¶ 2.
[4] *Id.* at ¶ 29-30.
[5] *See id.* at ¶ 75.
[6] *Id.* at ¶ 86.

telecommunication providers' USF contributions on the basis of the telephone numbers assigned to the providers' end users ("Proposal #3").[7]

I. THE INTERIM MEASURES ARE SUFFICIENT AND SHOULD BE GIVEN AN OPPORTUNITY TO WORK

CU *et al.* believe that the interim measures taken by the Commission will likely be sufficient to ensure the long-term stability of the USF. As the Commission itself has recognized, by increasing the safe harbor on wireless interstate telecommunication providers, universal service contributions will improve the sustainability of universal service funding mechanisms.[8] The attached affidavit of Dr. Mark Cooper, Director of Research of the Consumer Federation of America, demonstrates that the increased contribution from wireless carriers under the interim regulations should ensure the sufficiency and viability of the universal service funding mechanism.

Moreover, CU *et al.* believe that the interim measures enacted by the Commission will provide greater competitive incentives for carriers to reduce administrative inefficiencies associated with USF compliance, resulting in lower prices for consumers. The prohibition against assessing a mark-up above the established USF contribution factor will effectively lower the phone rates paid by many customers. Customers have been routinely required by carriers to pay "USF fees" well above the current USF contribution factor.[9] Prohibiting these mark-ups will allow greater transparency in carrier billing, thereby reducing consumer confusion caused by hidden surcharges and better enabling consumers to "shop around" for the truly lowest phone rates. Consequently, carriers will have a strong competitive incentive to reduce USF-related administrative costs, because consumers may now accurately compare phone rates among

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[7] *Second Further Notice* at ¶ 96.
[8] *See id.* at ¶ 21.
[9] *See id.* at ¶ 46.

carriers when shopping for long-distance service. The mark-up elimination will likely result in customers paying less in USF-related fees even if their carriers' USF contribution factor is increased, because this increase in contribution factor will probably be less than the "marked-up" rates customers were previously charged by carriers.

II. THE PROPOSALS FOR UNIVERSAL SERVICE FUND REFORM ARE CONTRARY TO THE COMMISSION'S STATUTORY AND PUBLIC POLICY OBLIGATIONS

Not only is it unnecessary for the Commission to replace the revenue-based system at this time, but each of the three alternative proposals raises significant questions under Section 254 of the Communications Act, which governs the FCC's universal service policies. All three proposals would assess a fee based on something other than customers' monthly interstate calling. Under Proposal #1, a variation of the plan initially offered by CoSus, carriers providing connections for end users to an interstate public or private network would be assessed a flat fee for every connection. In addition, interstate telecommunications carriers that do not provide connections but receive greater than *de minimus* revenue from their interstate telecommunication services would provide minimum annual contributions to the USF based upon their revenues.[10] Proposal #2 would assess all end-user connections on the basis of connection capacity, while interstate telecommunication services not directly providing connections to end users would continue to be assessed on a revenue-basis.[11] Proposal #3 would assesses telecommunication providers' USF contributions on the basis of the telephone numbers assigned to the providers' end users, while assessing special access and private lines that do not have assigned numbers on the basis of the capacity of those end-user connections.[12]

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[10] *Id.* at ¶ 75. *De minimus* revenue is defined as occurring whenever a provider receives less than $100,000 in annual interstate telecommunication revenue.
[11] *Id.* at ¶ 86.
[12] *Id.* at ¶ 96.

None of these proposals is sufficiently described and developed to allow complete evaluation. Nonetheless, based upon available information, it appears that all three fail to comply with Section 254's requirement that quality telecommunication service be made available to consumers at just, reasonable and affordable rates. Moreover, each of the three proposals fails to assess carriers in an equitable and nondiscriminatory manner.

A. The Proposals Are Inconsistent with the Principle that Rates be Just, Reasonable and Affordable

Section 254(b) requires the Commission to base policies for universal service upon a number of principles, the first of which is that "[q]uality services should be available at just, reasonable, and affordable rates."[13] The Commission has long recognized the importance of ensuring that carriers "not shift more than an equitable share of their contributions to any customer or group of customers."[14] Indeed, the Commission recognized the importance of preventing carriers from disproportionately passing along USF fees to low-volume consumers when it prohibited carriers from averaging contribution costs across all end-user customers and from charging a flat amount in excess of the interstate telecommunications portion of the bill times the relevant contribution factor.[15]

Under each of the three proposals, those users that are least profitable to long-distance carriers—low-volume and no-volume consumers—would see the greatest increase in their phone rates. In effect, these customers would subsidize rate reductions for more profitable, high-volume customers. This result cannot be reconciled with the Commission's obligation to base

[13] 47 U.S.C. § 254(b)(1).
[14] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 9199 (1997), as corrected by *Federal-State Joint Board on Universal Service*, Erratum, CC Docket No. 96-45, FCC 97-157 (rel. June 4, 1997), and Erratum, 13 FCC Rcd 24493 (1997).
[15] *Second Further Notice* at ¶ 51.

its USF policies upon the principle that consumers should only be charged just, reasonable, and affordable rates.

Because carriers' USF assessments under these proposals would be based upon the number of connections, connection capacity, or telephone numbers the carriers provided to their customers, as opposed to the actual revenue accrued from usage of those connections, it is likely that carriers will simply pass these flat fees directly onto the users of those connection lines.[16] The *Second Further Notice* does not assess the overall impact of imposing these fees on different classes of customers. But even assuming for purposes of argument that a flat connection-based fee could be shown to be equivalent to what the "average" residential customer currently pays in USF-related fees,[17] this "average" could only be attained by increasing phone rates for persons with "below-average" interstate calling patterns to offset reductions in the rates of persons with higher than normal usage patterns.

Indeed, residential customers with average interstate calling habits would likely pay more in USF fees under a connections-based approach. The data produced by CoSus in favor of its initial connections-based plan, which did not include assessments upon most interexchange carriers unlike Proposal #1 and Proposal #2, showed that 54% of residential households would pay more than they currently do if a connections-based system was adopted that charged

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[16] The proposals would therefore represent a de facto shift in USF contribution obligations from telecommunications carriers to consumers, and may fail to comply with the statutory requirements of the Communications Act. Section 254 makes it the responsibility of interstate telecommunications carriers to contribute to the USF. *See* 47 U.S.C. § 254. It does not call for any USF contribution obligations upon end users. If Congress intended for telecommunications users to sustain the USF, presumably it would have explicitly assigned telecommunications users with a USF fee, rather than telecommunications carriers. *See also* Comments of CU, *et al.*, CC Docket No. 96-45, filed April 22, 2002, at 13-14.

[17] The Commission previously noted that a preliminary staff analysis of an earlier connections-based proposal appeared to show that the average household would pay less under the proposal than under a revenue-based assessment methodology. *See Federal-State Joint Board on Universal Service*, Further Notice of Proposed Rulemaking and Report and Order ("*Further Notice*"), 17 FCC Rcd 3752, 3771-72 (2002). Because of the timing of the staff study released on February 26, 2003, CU *et al.* were unable to fully evaluate its conclusions before submitting comments on the *Second Further Notice*.

residential users $1.10 in monthly USF-related assessment fees.[18] The number of consumers adversely affected and the magnitude of these adverse affects is likely to be even more substantial under the three proposals than is suggested by CoSus's initial data. CoSus assumed for the purposes of its estimates that only those carriers that provided access connections to end-users would be assessed for USF contributions. However, both Proposal #1 and Proposal #2 mandate that carriers that do not provide connections to end users, such as wholesale carriers, must still contribute a percentage of revenue to the USF. Because these carriers' USF-related costs are also likely to be passed onto consumers, those customers that rely on both types of carriers for long-distance service would likely pay significantly more than the $1.10 in monthly USF-related fees that CoSus initially estimated.

1. Adoption of these Proposals Would Cause Low-Income and Elderly Consumers To Subsidize High-Volume Consumers

Adoption of proposals based on connection-based methodologies would be particularly injurious to low-income households, which typically spend significantly less on telephone service than other income groups. The U.S. Department of Labor estimates that households making more than $50,000 annually spend over $400 more each year on telephone expenditures than households making less than $20,000 each year.[19] Significantly contributing to this difference in telephone expenditures is the disparity in long-distance usage patterns between high and low-income households. Studies by the Florida Public Service Commission and the Yankee Group reveal that as income increases, long-distance usage tends to increase as well.[20] Indeed,

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[18] *See Declaration of Martha Behrend*, attached to Comments of CoSus, CC Docket No. 96-45, filed April 22, 2002, at Table 1 ("*CoSus Study*"). Only a minority of telecommunications users—those customers with the greatest interstate telecommunications usage that produce the largest amount of revenue for the telecommunications industry—would receive any benefit from a connection-based assessment methodology. *Id.*
[19] *See* Exhibit 6.
[20] *See* Exhibit 5.

those households making over $70,000 a year use long-distance services more than twice as much as the lowest income households.[21]

Elderly consumers as a group would also experience an increase in long-distance rates under the connections-based methodology used by each of the three proposals. A recent AARP study shows that persons over 65 make roughly half the number of weekly long-distance calls as adults under 65,[22] and seniors spend significantly less on long distance expenditures than other age groups.[23] Many elderly persons live on fixed incomes, and unavoidable increases in their long-distance bills under a connections-based USF assessment system will force some to make difficult financial choices that could otherwise be avoided under the present assessment system, in which consumers' USF fees are determined by their long-distance usage.

In sum, all three proposals would in effect require low-income and elderly persons—those customers that contribute the smallest amount of telecommunications activity or revenue and are least able to afford long-distance service—to subsidize price reductions for those customers best able to afford long-distance service. Adoption of any of these proposals would reverse the Commission's previous protections of consumers from inequitable cost-shifting by carriers, and would be contrary to Section 254's requirement that the assessment methodology implemented by the Commission ensure that consumers receive telecommunications service at just, reasonable and affordable rates.

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[21] *See id.* These conclusions are corroborated by data presented by CoSus, which demonstrates that low-income consumers would, as a group, be more adversely affected by a connections-based USF assessment methodology than any other income group, with 62% paying more in USF-related fees than they do presently. *See CoSus Study*. This data is based on the optimistic assumption that consumers would only pay $1.10 in USF fees and associated administrative costs for each residential-line connection on a monthly basis. The only income group that would see an overall decrease in USF charges under the plan advocated by CoSus would be those households with annual incomes greater than $70,000, of which 56% would benefit from a connection-based system. *Id.*

[22] Christopher A. Baker & Ann McLarty Jackson, Public Policy Institute, *Consumer Pricing Practices and Savings Opportunities in the Long Distance Telephone Industry: Findings from an AARP Survey* Figure I.2 (2000).

[23] *Id.* at Figure I.3.

2. The Administrative Costs of the Proposals Will Further Aggravate Unjust and Unreasonable Rates

The proposals also entail administrative costs that further make the ultimate rates charged to consumers unjust, unreasonable, and unaffordable. For example, under Proposal #2, the USF contribution obligation for each end-user connection would be shared between switched access and interstate transport providers.[24] Interexchange carriers, as some have noted, generally do not have access to information regarding end user access connections.[25] Interexchange carriers will seek to pass the cost of collecting this information onto their customers. Thus, Proposal #2 would directly raise prices for those consumers that rely on interexchange carriers for their long-distance service. Proposal #2 may also indirectly increase phone charges for all customers by reducing interexchange carriers' ability to compete with wireless and local exchange carriers not subject to such information costs.

Proposal #3 would also result in increased charges for consumers by decreasing competition incentives for keeping USF-related administrative costs low. Under the present USF assessment methodology, the sharing of USF contribution obligations between different classes of carriers rewards administrative efficiency. Because consumers are able to select their long-distance service from a number of interexchange, wireless, and local exchange carriers, consumers have the ability to "shop around" for the carrier with the lowest USF-related service charges. Proposal #3 would exempt most interexchange carriers from meaningful USF contribution obligations, leaving local exchange carriers responsible for the vast majority of funds. Because consumers generally have a very limited choice in selecting local exchange

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[24] *Second Further Notice* at ¶ 86.

[25] *Id.* at ¶ 88 n.186, *citing* Letter from John T. Nakahata, Counsel to the Coalition for Sustainable Universal Service, to Marlene Dortch, Federal Communications Commission, filed Sept. 9, 2002.

carriers, local exchange carriers lack the competitive incentive to keep administrative costs related to USF assessments low.

3. More Data is Needed to Fully Assess the Impact of these Proposals on Consumers

A more complete analysis of whether the rates for low-use consumers under these three proposals is just, reasonable, and affordable is hindered by the lack of specific information provided by the Commission about each proposal.[26] With regard to Proposal #1, the Commission has only provided estimates of the initial flat USF fees it would assign under the proposal. While implicitly suggesting that these rates will ultimately need to be raised,[27] it provides no information as to the amount or relevant time frame. Additionally, the Commission has not provided any estimates regarding the amount that carriers will be assessed for multi-line business connections under Proposal #1, beyond stating that these connections will be assessed at rates "sufficient to cover residual funding requirements."[28] It remains unclear what percentage of USF contributions will come from the assessment of multi-line business connections, thus preventing commenters from determining whether Proposal #1 would place an inequitable USF contribution burden upon residential lines, to the particular detriment of low-volume residential customers.[29] The Commission also does not estimate the percentage of revenue that stand-alone

[26] CU *et al.* recognize that the Commission recently released a staff study that may further elaborate upon the proposals. *See Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket No. 96-45, FCC 03-31 (rel. February 26, 2003). Due to time constraints before filing, CU *et al.* have not had the opportunity to fully evaluate this study. After having the opportunity to more carefully review the staff study, CU *et al.* intend to submit comments regarding its findings.

[27] Under Proposal #1, carriers providing end users with access to an interstate public or private network would *initially* be assessed a $1.00 monthly fee for each residential, single-line business, payphone, and mobile wireless connection, $.10 a month for one-way pager connections, and $.20 for two-way pager connections. *Second Further Notice* at ¶ 75. These fee rates are only preliminary, however, as the proposal provides for a one year transition period to enable providers to modify billing systems and to allow time for the Administrator to compile data necessary to "finalize the calculation of initial assessment rates." *Id.* at ¶ 77.

[28] *Id.* at ¶ 75.

[29] The Commission has not informed commenters regarding how additional funding will be attained under Proposal #1 if initial fee rates prove insufficient. The Commission has not explained whether additional funding will be primarily derived from an increase in the connection fees for multi-line businesses alone, from an increase in the

carriers will be required to contribute under Proposal #1 and Proposal #2,[30] thereby preventing commenters from estimating the total amount of USF fees likely to be passed onto consumers under these proposals.

Moreover, the Commission does not provide any estimates of the number of connections that would be assessed under Proposals #2 and #3. Although the Commission has stated that "assessments on a typical residential connection [under Proposal #2] would be higher than under the first proposal,"[31] it has not quantified the amount that it expects rates to increase. Furthermore, because the Commission does not provide information about whether and how different types of telecommunications services will be assessed under Proposal #3,[32] commenters have no way of assessing the magnitude that low-volume users' phone rates will increase under the proposal, because the magnitude of the rate increase will be in part determined by the number and types of carriers that will be assessed under the proposal.

B. The Proposals Fail To Assess Telecommunications Carriers in an Equitable and Nondiscriminatory Manner

The Commission is required to establish a USF assessment methodology that ensures that "*[e]very* telecommunications carrier that provides interstate telecommunications" contributes to the USF, so long as the carrier's contribution would be greater than a *de minimus* amount.[33] Pursuant to Sections 254(b)(4) and 254(d) of the Communications Act, the Commission is obligated to establish a USF assessment mechanism that assesses carriers on "an equitable and

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connection fees on other types of connections, or from increasing the assessment rates on all connections by a presently undetermined rate. Until the Commission clarifies the role multi-line business connections will play in assessing carriers' USF contributions, it is unclear whether the proposal unduly favors carriers serving a greater percentage of multi-line business connections, and disadvantages residential users in comparison to business users.

[30] *See id.* at ¶¶ 76-80, 86.

[31] *Id.* at ¶ 87.

[32] *Id.* at ¶¶ 96-98.

[33] 47 U.S.C. § 254(d) (emphasis added).

nondiscriminatory" basis.[34] Because the proposals presented by the Commission fail to fulfill these requirements by unfairly imposing greater USF obligations upon certain carriers than others, they should not be adopted.

1. Connection-Based Assessments Would Inequitably Require Low-Volume Carriers to Contribute a Greater Portion of Their Revenue to the USF than Higher-Volume Carriers.

Under the present methodology employed by the Commission, an interstate telecommunication carrier's contribution obligation to the USF is assessed based on the carrier's interstate revenue. As a carrier's interstate telecommunication revenue increases, the amount that a carrier must contribute to the USF rises proportionately. All three proposals presented by the Commission would replace this methodology, in whole or in part, with a system that would assess carriers a flat fee for each connection or phone number that they served. This change in assessment methodology would lead to inequitable results. Under the connection-based proposals, a carrier that provided low-volume users with connection lines would be assessed the same USF contribution obligation as a high-volume carrier providing the same amount of connections to its customers, despite the fact that the low-volume carrier's telecommunications revenue and activity is far less than that of the high-volume carrier.

A connection-based USF assessment methodology would therefore place a disproportionate burden on those carriers marketing specifically to low-volume and low-income consumers that might otherwise be unable to afford long-distance service. Prepaid wireless services that enable low-income and low-volume users to receive limited but affordable long-

[34] 47 U.S.C. § 254(b)(4) (requiring the Commission to establish a USF assessment system based upon the principle that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service"); 47 U.S.C. § 254(d) ("Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service.").

distance service would have to pay considerably more under a connections-based approach than under a methodology that assessed them on the basis of their actual contribution to interstate telecommunications activity. TracFone, for example, has estimated that its USF contribution obligations would increase by 488% if the Commission replaced the revenue-based USF assessment system with a connection-based system.[35] Meanwhile, a carrier serving a smaller number of customers, but having a much higher volume of interstate telecommunication activity and revenue, would see its USF contribution rates decrease.

Telecommunications carriers can only be treated in a nondiscriminatory manner if differences in telecommunications activity among carriers are taken into account, and an assessment system is not imposed that unjustly favors certain carriers at the expense of others. Any methodology that requires a carrier to pay more into the USF than a carrier responsible for a far greater amount of interstate telecommunications activity and revenue cannot be considered "equitable and nondiscriminatory" in its treatment of carriers. Accordingly, the flat assessment proposals presented by the Commission fail to fulfill the statutory requirements of Sections 254(b)(4) and 254(d), and must therefore be rejected.

2. Proposal #3 Wrongfully Exempts Interexchange Carriers from Meaningful USF Contribution Obligations.

Proposal #3, which would assess carriers for every end-user telephone number served, fails to comply with the requirements of Section 254(d) that oblige *every* interstate telecommunications carrier to contribute to the USF.[36] Proposal #3 would enable many interexchange carriers, such as WorldCom and AT&T, to avoid making meaningful

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[35] *See* Comments of TracFone Wireless, Inc., CC Docket No. 96-45, filed April 22, 2002, at 6. This estimate was based upon the optimistic assumption that carriers would be charged a flat $1.00 fee for every residential line served under a connection-based approach.
[36] *See* 47 U.S.C. § 254(d).

contributions to the USF, because these carriers are typically not responsible for assigning phone numbers to their customers. This enormous loophole would shift the burden of USF contribution from interexchange carriers to local exchange carriers and wireless providers. The number-based proposal therefore does not satisfy the Commission's mandate to construct an equitable and nondiscriminatory USF assessment system covering *every* non-*de minimus* interstate telecommunications carrier,[37] and it must therefore be rejected.

3. The Imposition of Different Assessment Methodologies on Carriers with Similar Revenues under Proposals #1 and# 2 Is Discriminatory.

Proposal #1 and Proposal #2 attempt to address coverage gaps of a purely-connection based system by assessing different telecommunications carriers through different assessment methodologies. Under each of these proposals, those carriers that provide end-users with a connection to a public network would be charged on a per-connection basis, while all other carriers would be assessed on the basis of interstate revenue.[38] Under either proposal, carriers responsible for similar volumes of telecommunication activity but assessed using differing methodologies might have wildly disparate USF contribution obligations.[39]

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[37] Interexchange carriers have proven capable of contributing far more than a "*de minimus*" amount to the USF, meaning that their exemption from meaningful coverage under Proposal #3 has no valid statutory justification. In 1999, interexchange carriers accrued $99 billion in long distance revenues, while local exchange carriers amassed only $9 billion in long distance revenues. *See* FCC, Common Carrier Bureau, Industry Analysis Division, *Statistics of the Long Distance Telecommunications Industry* 1 (rel. Jan. 24, 2001). Interexchange carriers presently account for 63% revenue assessed for the federal USF program. *See Further Notice*, 17 FCC Rcd at 3756.

[38] *See Second Further Notice* at ¶¶ 76-80, 86.

[39] This disparity in USF obligations may also result in increased phone rates for consumers by reducing competition among carriers assessed under differing methodologies. Because connection-based and revenue-based methodologies rely upon different assessment principles, a dual methodology system will invariably impose different carrier costs upon carriers assessed under differing methodologies. As a result, carriers of one methodology will have to incorporate greater financial costs and therefore offer higher phone rates than carriers operating under the alternate methodology. Not only would customers of carriers assessed under one methodology have to pay higher phone charges than customers of carriers operating under the other methodology, but overall phone rates for all telecommunications customers would likely increase as well. Because carriers operating under a low-assessment methodology need not worry about losing their customers to carriers compelled to operate under the

Although Proposal #1 and Proposal #2 attempt to ensure that every telecommunications carrier contributes to the USF by employing both connection-based and revenue-based assessment methodologies, these proposals will be unable to consistently assess carriers on an equitable and nondiscriminatory manner, and should therefore be rejected as incompatible with the Commission's statutory mandate.[40] The reliance on dual methodologies makes it practicably impossible for carrier coverage to be equitable and nondiscriminatory. Any similarity in contribution levels between carriers operating under different assessment methodologies would be entirely coincidental and non-permanent, because these assessment systems revolve around entirely different principles; a connection-based methodology assesses carriers based upon the number of connections served, whereas the revenue-based methodology assesses carriers based upon the profits gained through the actual usage of those connections. Because of the impossibility of employing dual assessment methodologies in a manner that would treat carriers in an equitable and nondiscriminatory manner, Proposal #1 and Proposal #2 do not comply with the requirements of Section 254 and therefore should not be adopted.

CONCLUSION

The interim measures to strengthen the USF assessment system adequately address concerns regarding the long-term sustainability of the USF, and therefore should be given the opportunity to succeed. The Commission should reject the proposals to replace these interim measures with a system that would inequitably shift the burden of USF assessment onto low-

methodology imposing higher USF contribution obligations, they would have less incentive to reduce customer phone rates.

[40] The Commission has not provided the set percentage of revenue that those carriers that will be assessed under a revenue-based methodology will be required to contribute to the USF, making it impossible for commenters to determine whether a connection-based or revenue-based methodology will be more favorable to carriers. Nevertheless, the methodologies' reliance upon different principles means that similarly-situated carriers assessed using different methodologies will have unavoidably different USF obligations.

volume consumers and carriers, as these proposals are contrary to the Commission's statutory and public policy obligations.

Respectfully Submitted,

___/s/____________________

James A. Bachtell, Esq.
Angela J. Campbell, Esq.

Institute for Public Representation
Georgetown University Law Center
600 New Jersey Avenue, N.W.
Washington, D.C. 20001
(202) 662-9535

Counsel for CU *et al.*

Of Counsel:

Michael Garcia
Georgetown University Law Center

Law Student

Mark Cooper
Director of Research
CONSUMER FEDERATION OF AMERICA
1424 16th Streeet NW
Suite 604
Washington, DC 20036
(202) 387-6121

Laurie Pappas
Deputy Public Counsel
Texas State Bar No. 12128690
Texas Office of Public Utility Counsel
1701 North Congress Ave.
Suite 9-180
P.O. Box 12397
Austin, TX 78711-2397
(512) 936-7500

Dated: February 28, 2003

AFFIDAVIT OF DR. MARK N. COOPER

I. THE INTERIM UNIVERSAL SERVICE FUNDING MECHANISM IS SUFFICIENT, ADMINISTRATIVELY PREFERABLE AND COMPETITIVELY NEUTRAL

The recent modifications that the Commission has made to the universal service fund mechanism have addressed the major problems that were identified in the Notice of Proposed Rulemaking. The interim measures provide a more than adequate basis to ensure the economic viability and competitive neutrality. Rather than radically alter the universal service mechanism in a manner that increases the burden on low-volume and low-income households, as does each of the alternatives identified in the *Second Further Notice* the Commission should monitor and develop the interim approach.

The critical change has been the recognition that the contribution of wireless to universal service had to be increased. With well over 100 million wireless phones being used in the country, the Commission must continue to explore the extent to which contribution from this source should be expanded. It is quite clear that wireless benefits from the ubiquitous telephone network and should make an equitable contribution to support that network. Moreover, it is quite clear that wireless has captured substantial revenues from the long distance market, which has been the base used for funding universal service.

With the switch from historic to projected revenues, the funding mechanism has corrected the problem interexchange carriers suffer because of declining usage. Much of that decline has been due to the growth of cellular, so the two solutions reinforce one another.

Because connection-based methodologies exempt carriers that do not sell connections directly to the public, they create competitive problems. The resulting patches create a complex and unwieldy administrative apparatus that inevitably leads to competitive inequities.

II. USE OF THE NETWORK IS THE PROPER BASE FOR ASSESSING UNIVERSAL SERVICE CONTRIBUTIONS AND CELLULAR USE IS THE KEY TO EXPANDING THE FUNDING BASE

Ensuring universal service as a public policy is grounded, at least in part, in the recognition that telecommunications exhibits network externalities. The larger the number of subscribers on the network, the greater the value of the network to all subscribers. Although it is difficult to measure who derives the greatest benefit from the network externality, the most reasonable basis on which to base that analysis is on usage. The presumption underlying the concept of a direct communications network externality is that it facilitates more intensive use of that network. It is reasonable to assume that those who actually use the network most intensively derive the greatest benefit from the network effect. Recovering the costs in proportion to use aligns costs and benefits most closely.

Cellular service has grown rapidly over the past half decade. The value of wireless service still rests substantially on its ability to interconnect with and receive or deliver calls from the wireline network, which has been extended to ubiquity with universal service policies. It is hard to imagine the wireless network grown to 100+ million subscribers as it has in the past half decade if wireless customers could only reach other wireless customers. Consequently, wireless telephony should make an equitable and fair contribution to universal service.

One of the important drivers of universal service accomplishment has been the ability to expand the base of users to support the ubiquity of the network. With the wireless industry having gone through a period of phenomenal growth in recent years, now is the proper time to bring this telecommunications service fully into the base of universal service.

III. A FAIR CONTRIBUTION FROM WIRELESS SOLVES THE ADEQUACY PROBLEM

Exhibit 1 shows the growth of the revenues of the three dominant types of telecommunications service providers, local, interexchange carriers (long distance) and wireless. Between 1996 and 2001, local exchange revenues grew by about $23 billion. Long distance revenue grew by about $7 billion. Wireless revenues grew by over $50 billion. Fully one-quarter of all revenues were accounted for by wireless (see Exhibit 2).

Comparing growth rates of revenues before and after the passage of the 1996 Act suggests that wireless has affected long distance much more than local (see Exhibit 3). Local revenue growth slowed slightly, from 4.1% to 3.7% per year. Long distance revenue growth slowed from 9.1% to 1.5%.

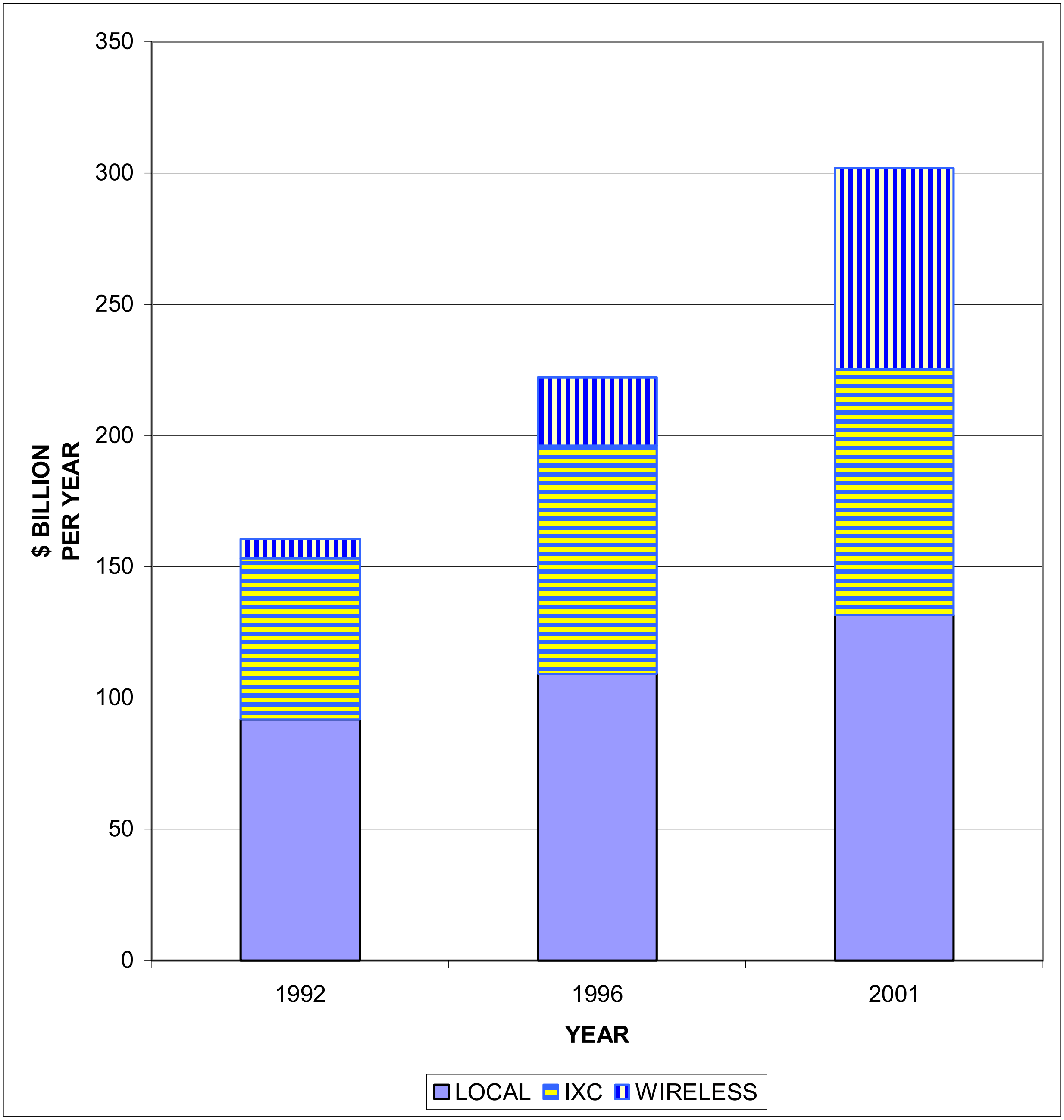
Price changes cannot account for the dramatic difference (see Exhibit 4). In the 1992 – 1996 interstate long distance rates increased about 10%, or about 2.4% per year. In the 1996-2001 period, they declined about 15%, or about 2.8% per year. Although prices were declining in the more recent period, usage grew much more slowly. In 1992 –1996, interstate minutes increased by about 7.5% per year. In 1996 – 2001, usage increased by 2.8% per year. In fact, for the first time since divestiture, interstate minutes of use declined on a year-to-year basis, by 5%.

IV. SHIFTING TO A CONNECTION-DRIVEN FUNDING BASE IS UNFAIR TO LOW VOLUME, LOW INCOME CONSUMERS

The Commission recognizes that a shift to a connection-driven funding base will increase the burden on consumers who use the interstate network least. We have shown throughout the universal service proceedings that low income households are disproportionately low volume households. Exhibit 5 presents a variety of sources that indicate this relationship. Upper income households have between two and three times the level of usage of lower income households.

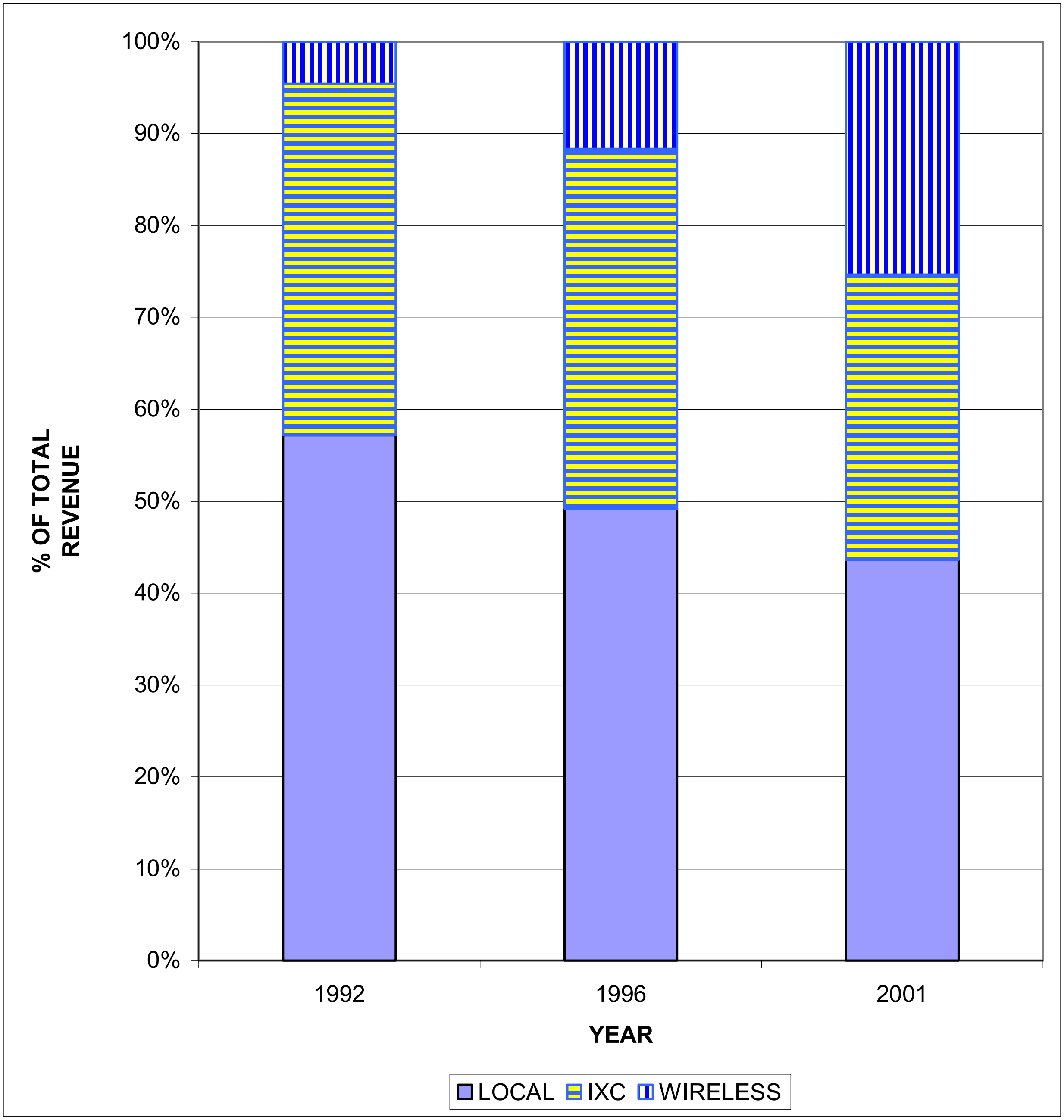
The striking increase in wireless subscription and usage reinforces this aspect of the analysis. Exhibit 6 shows the changes in household expenditures for telephone service between 1996 and 2001 for income groups as reported by the Consumer Expenditure Survey. There was a sharp increase in expenditures for the higher income groups (households with incomes above $30,000). Those households increased their expenditures by more than $100 per year. For lower income groups, the increase was about $20 per year (see Exhibit 7). Even measured in percentage terms, the increase in upper income usage is between two and three times as large (see Exhibit 8).

EXHIBIT 1: TELECOMMUNICATIONS INDUSTRY REVENUES: 1992, 1996, 2001



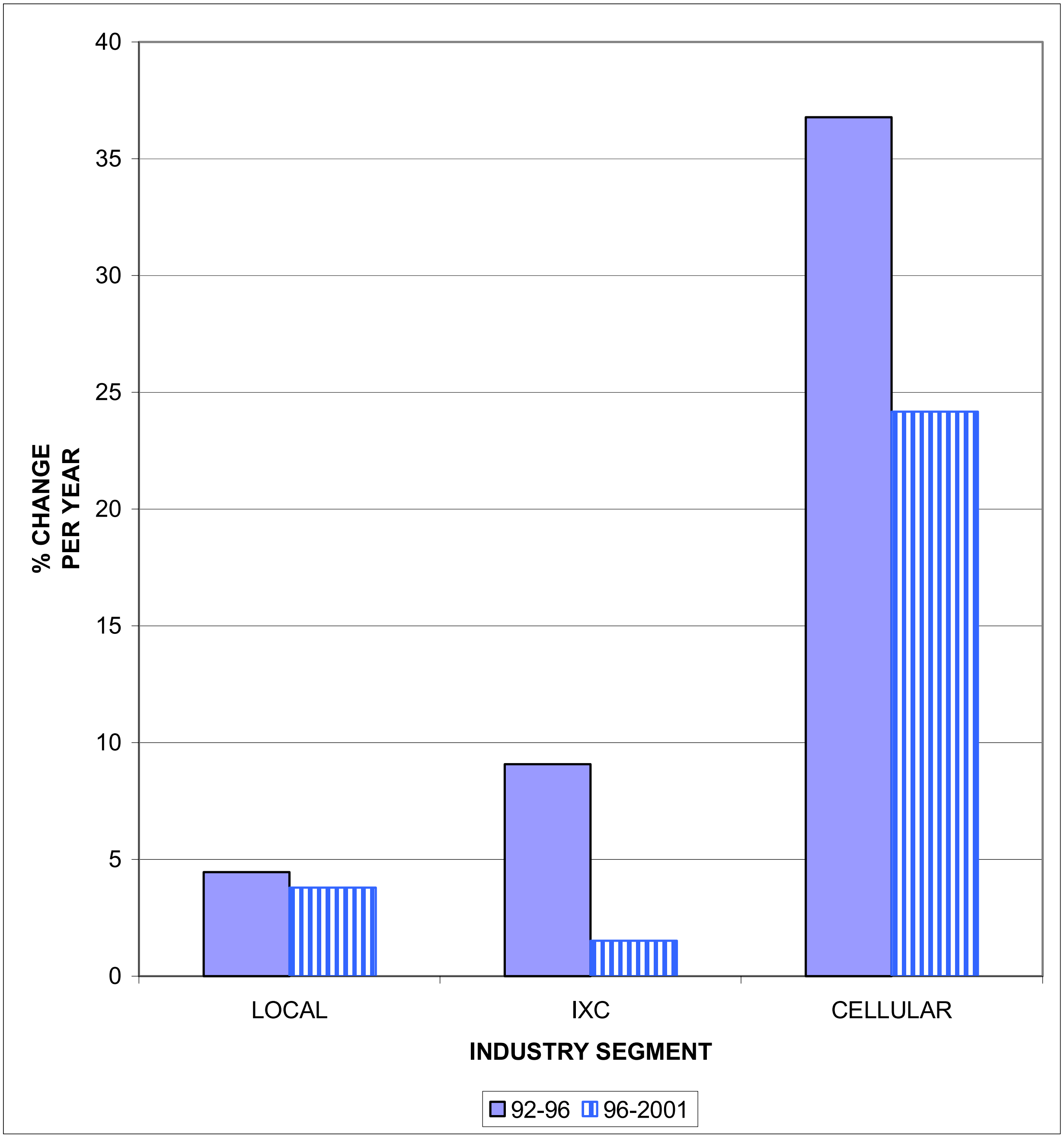
SOURCE: Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telecommunications Service* (Federal Communications Commission, May 2002), Table 16.4.

EXHIBIT 2: COMPOSITION OF TELECOMMUNICATIONS INDUSTRY REVENUE, 1992, 1996, 2001



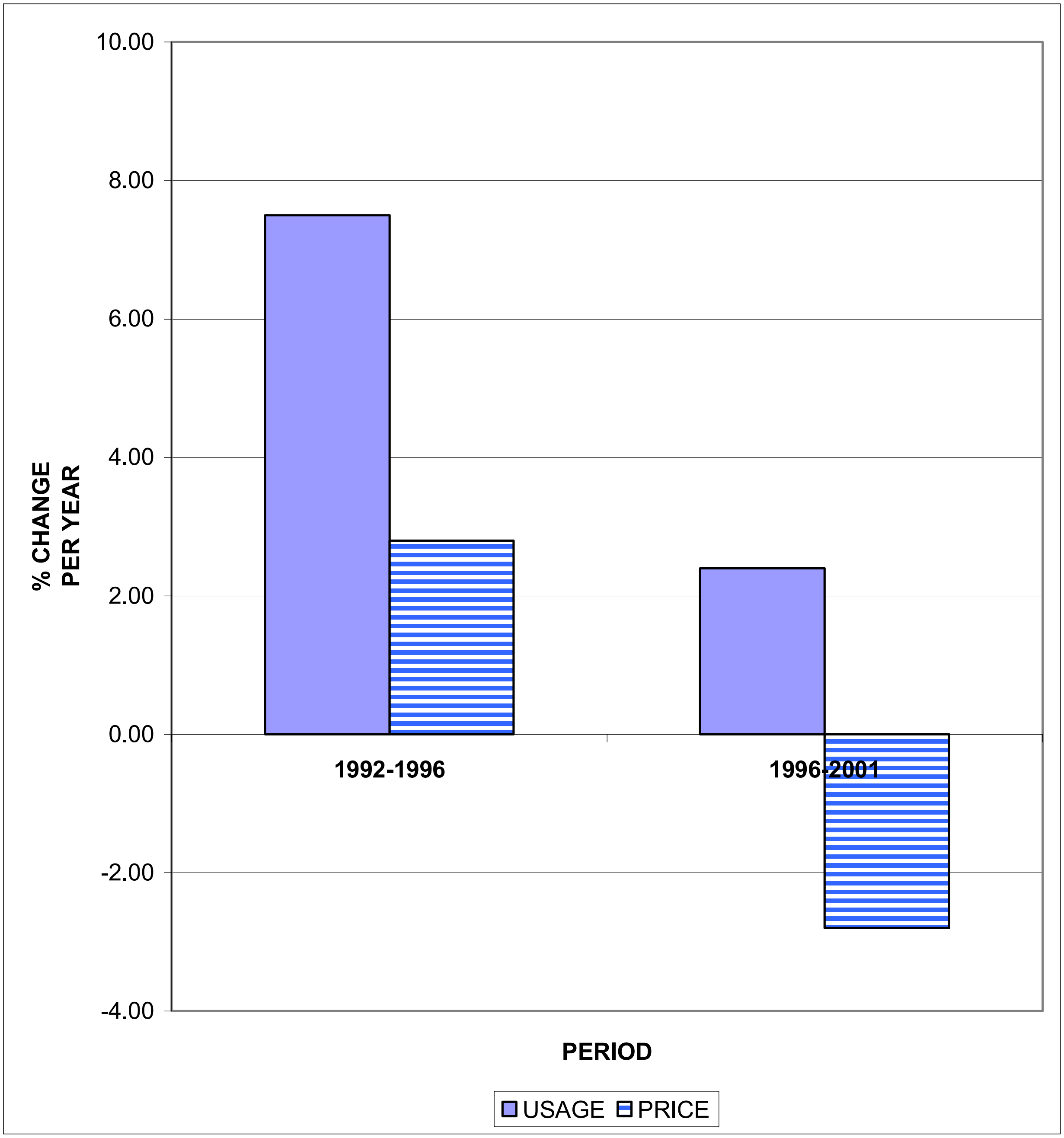
SOURCE: Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telecommunications Service* (Federal Communications Commission, May 2002), Table 16.4.

EXHIBIT 3: ANNUAL GROWTH OF REVENUES: 1992 - 1996, 1996 - 2001



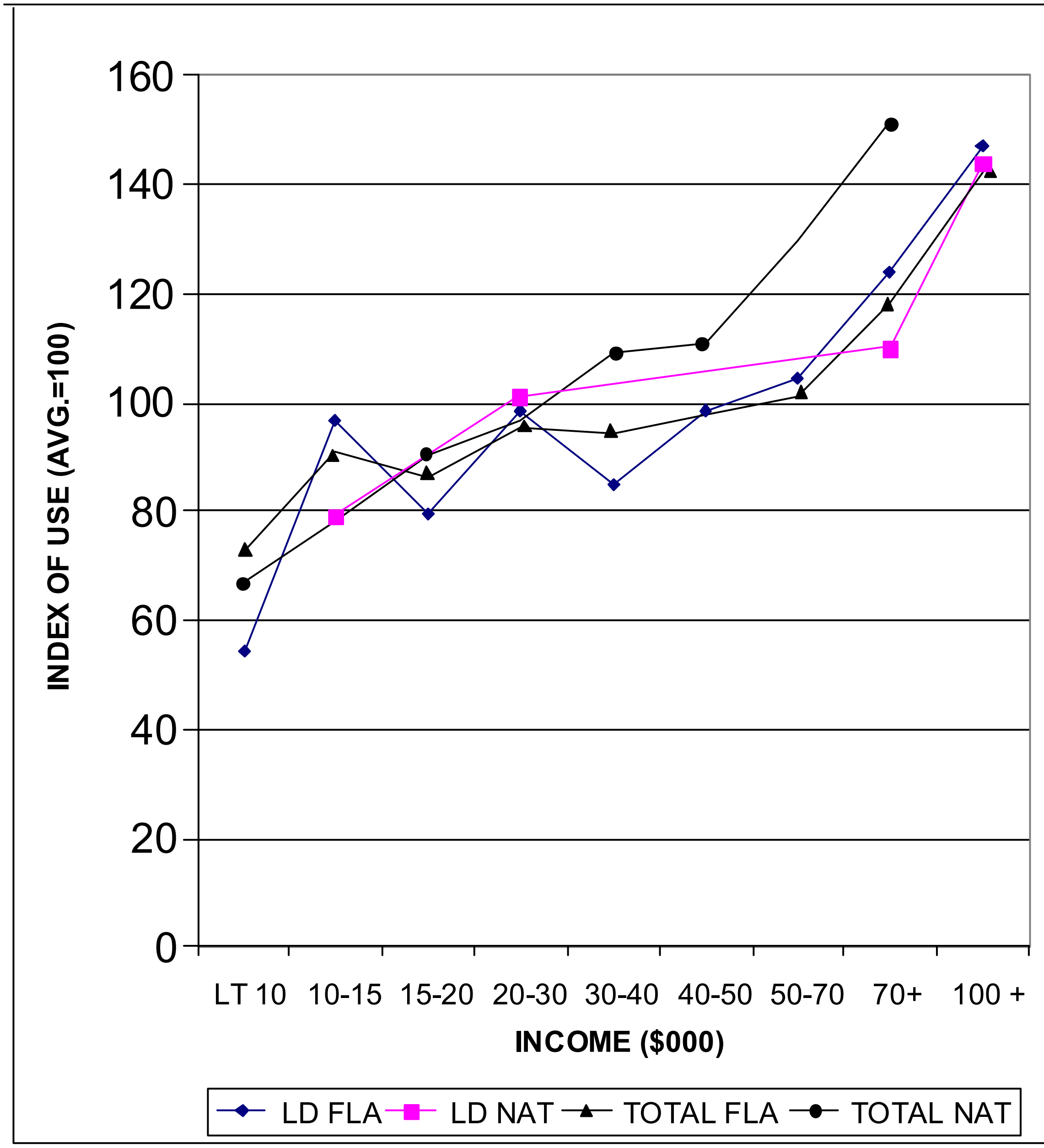
SOURCE: Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telecommunications Service* (Federal Communications Commission, May 2002), Table 16.4.

EXHIBIT 4: LONG DISTANCE PRICING AND USAGE: 1992, 1996, 2001



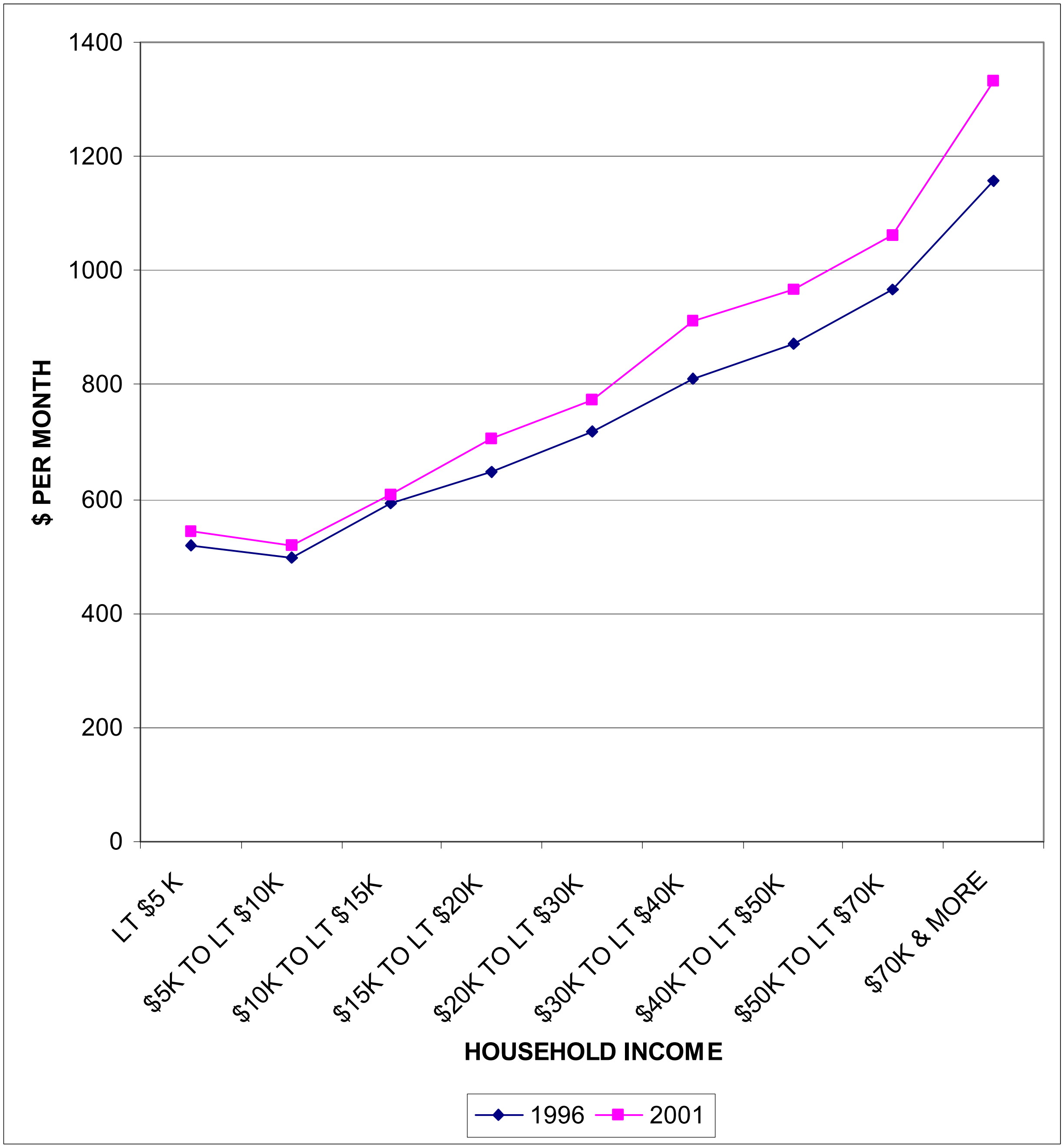
SOURCE: Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telecommunications Service* (Federal Communications Commission, May 2002), Table 11.3.

EXHIBIT 5: INCOME AND USAGE



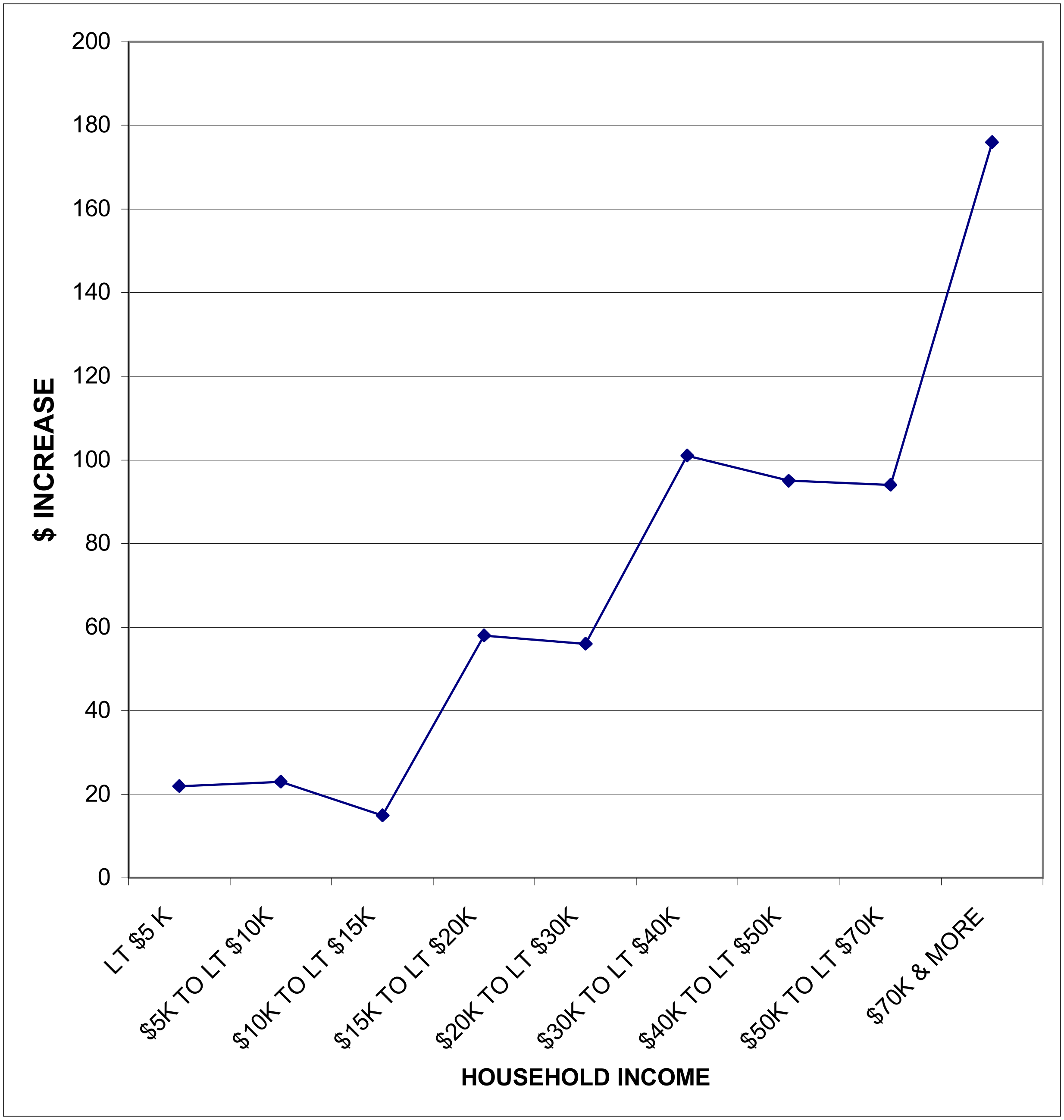
SOURCE: Florida PSC Survey; Bureau of Labor Statistics, *Consumer Expenditure Survey: 1997*; The Yankee Group, *Understanding Consumer Spending on Communications*, December, 1999.

EXHIBIT 6: EXPENDITURES ON TELEPHONE BY HOUSEHOLD INCOME, 1996 v. 2001



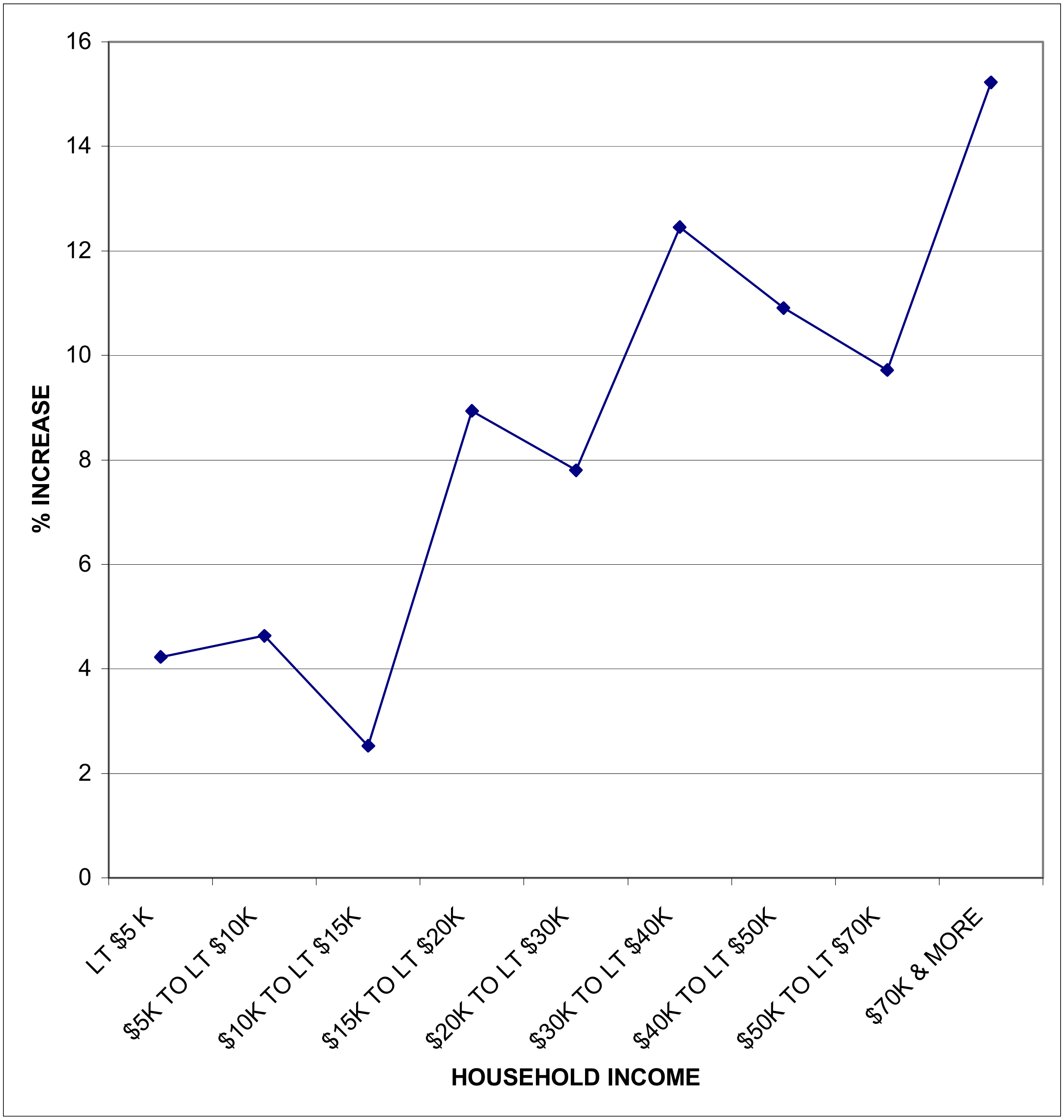
SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, *Current Population Survey,* Public Data Query, Series Id. CXUUTT00201, visited February 15, 2003.

EXHIBIT 7: DOLLAR INCREASE IN EXPENDITURES ON TELEPHONE BY HOUSEHOLD INCOME, 1996 v. 2001



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, *Current Population Survey,* Public Data Query, Series Id. CXUUTT00201, visited February 15, 2003.

EXHIBIT 8: PERCENTAGE INCREASE IN EXPENDITURES ON TELEPHONE BY HOUSEHOLD INCOME, 1996 v. 2001



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, *Current Population Survey,* Public Data Query, Series Id. CXUUTT00201, visited February 15, 2003.